Decision **DRAFT DECISION OF COMMISSIONER LYNCH**
(Mailed 7/22/2003)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (E 3338-E) for Authority to Institute a Rate Stabilization Plan with a Rate Increase and End of Rate Freeze Tariffs.	Application 00-11-038 (Filed November 16, 2000)
Emergency Application of Pacific Gas and Electric Company to Adopt a Rate Stabilization Plan. (U 39 E)	Application 00-11-056 (Filed November 22, 2000)
Petition of THE UTILITY REFORM NETWORK for Modification of Resolution E-3527.	Application 00-10-028 (Filed October 17, 2000)
William Ahern, Janet Beautz (for Santa Cruz County Board of Supervisors), Charlie Betcher, Robert J. Boileau, William Burns, Alvin Colley, James Crettol, Michael Gallo, Dave Hennessy, Dennis Herrera, Nettie Hoge, Walter Johnson, Fred Keeley, Reggie Knox, William Knox, Bruce Livingston, Elizabeth Martin, Barbara McIver, Robert Meacher, Deidra O'Merde, Elizabeth Sholes, Mary Frances Smith, Ladan Sobhani, Peter Van Zant, Mary Ann Woomer, and Carl Zichella, Complainants, vs. Pacific Gas and Electric Company, Defendant.	Case 02-02-027 (Filed February 27, 2002)
Application of PACIFIC GAS AND ELECTRIC COMPANY for Review and Recovery of Costs Recorded in the Electric Restructuring Costs Account (ERCA) for 1999 and Forecast for 2000 and 2001. (U 39 E)	Application 00-07-013 (Filed July 11,2000)

INTERIM OPINION REGARDING END OF RATE CONTROL PERIOD AND VALUATION OF GENERATION-RELATED ASSETS

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INTERIM OPINION REGARDING END OF RATE CONTROL PERIOD AND VALUATION OF GENERATION-RELATED ASSETS

1. Summary

Assembly Bill (AB) 1890, enacted in 1996, set electricity rates at specific levels until the earlier of March 31, 2002, or when certain events occurred. In March 2001, we found that the conditions to permit rate adjustments under AB 1890 in advance of March 31, 2002 had not been met. (Decision (D.) 01-03-082.) In January 2002, we granted limited rehearing on that issue. (D.02-01-001.)

We now find that the rate controls pursuant to AB 1890 ended on January 18, 2001, and that it is unnecessary to perform valuation of utility retained generation assets in identifying this date. We initiate Phase 2 of this rehearing proceeding to determine the extent and disposition of what formerly were called "transition" or "stranded" costs. Given the relationship of the issues, we consolidate Application (A.) 00-07-013 (electric restructuring costs) with Phase 2. The proceeding remains open.

2. Background

2.1. Rate Controls and Energy Crisis

In 1996, the California Legislature enacted AB 1890. AB 1890 sought an orderly transition of the electricity generation market from cost-of-service-based rate regulation to competition for the purposes of encouraging innovation, efficiency and better service; reducing regulatory oversight; and ultimately lowering electricity rates. (Public Utilities Code Sections 330(a), (e) and (t).[1])

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[1] Unless otherwise stated, all statutory references are to the Public Utilities Code.

As one important element of a complex scheme to accomplish these goals, AB 1890 set retail electric rates beginning in 1998 at rate levels that were in place on June 10, 1996. AB 1890 also established an additional 10 percent rate discount for residential and small commercial customers. The fixed rate levels were to end the earlier of March 31, 2002, or the date on which certain Commission-authorized transition costs were determined by the Commission to have been fully recovered. (§§ 367 and 368.) The rate levels fixed by AB 1890 were higher than the utilities' then current costs to provide utilities an opportunity to recover some or all transition costs during the transition to a competitive market. In exchange, utilities took the risk that all transition costs would not be recovered by March 31, 2002.

The wholesale generation market, however, became exceedingly dysfunctional, and wholesale costs paid by utilities escalated to extraordinarily high levels. The AB 1890 balancing of competing interests in pursuit of its public policy goals neither contemplated sellers manipulating the market to increase wholesale electricity prices, nor the Federal Energy Regulatory Commission (FERC) failing to establish and enforce just and reasonable wholesale rates. The dramatic market manipulation by sellers in 2000 and 2001 destroyed the fundamental balance of these competing interests, and the premise upon which AB 1890 rested. The extremely high costs (due to the dysfunctional market) but limited revenues (due to the AB 1890 rate controls) contributed to Pacific Gas and Electric Company (PG&E) and Southern California Edison Company (SCE) facing serious financial distress in 2000 and 2001.[2] This distress jeopardized system reliability, the State's economy, and the welfare of the State's citizens.

On January 17, 2001, the Governor responded to the crisis by proclaiming a State of Emergency. The Governor ordered immediate remedies, including the procurement and sale of electricity by the California Department of Water Resources (DWR).

The Legislature responded to the crisis by, among other things, adopting AB 6X[3] in its First Extraordinary Session. AB 6X became effective on January 18, 2001. This legislation cancelled the AB 1890 transition of utility generation from regulated to unregulated status, terminated the requirement for market valuation of generation assets as part of the transition, and continued Commission regulation of utility owned assets. Further, it prohibited disposal of any utility owned generation before January 1, 2006, and required that the Commission ensure continued dedication to public service of public utility retained generation assets.

The Legislature also adopted AB 1X,[4] which became effective on February 1, 2001. This law required that DWR procure electricity for resale to the customers of California utilities. It also required that the Commission assess charges on electric utility customers enabling DWR to recover its costs.

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2 San Diego Gas & Electric Company (SDG&E) did not face the same type of financial distress since the legislatively mandated rate freeze for SDG&E had already ended.

3 Assembly Bill No. 6 (Stats. 2001, First Extraordinary Session, Ch. 2).

4 Assembly Bill No. 1 (Stats. 2001, First Extraordinary Session, Ch. 4).

The Commission addressed the crisis by, among other things, adopting a \$0.01 per kilowatt-hour (kWh) surcharge effective January 4, 2001, and an additional \$0.03/kWh surcharge effective March 28, 2001, for a cumulative increase of about 40%. (D.01-01-018 and D.01-03-082, respectively.) We corrected transition cost accounting by adopting an "accounting true-up" to properly assess the recovery of transition costs over the entire rate control period, as intended by AB 1890.[5] (D.01-03-082, Ordering Paragraph 7.) We also found that the AB 1890 rate controls had not ended for either PG&E or SCE. (D.01-03-082, Ordering Paragraph 9.)[6]

D.02-01-001 granted limited rehearing of D.01-03-082 "on the issue of whether rate controls under AB 1890 should be ended." (D.02-01-001, Ordering Paragraph 2.) We stated that the rehearing should address the impact of AB 6X on the AB 1890 rate control paradigm, and the actual date of the end of the rate control period. We also indicated our expectation that issues involved in this determination are legal as opposed to factual, and could be resolved after briefing. We directed the Administrative Law Judge (ALJ) Division to

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[5] Before correcting the accounting, utilities might have "collected their stranded capital costs, while at the same time recording monthly liabilities of billions of dollars in operating costs." (D.01-03-082, mimeo., page 25.) As corrected, the accounting now ensures that revenues are applied to operating costs first, with any remaining revenues then applied to uneconomic, transition, or stranded costs. Moreover, the corrected accounting applies this approach over the entire rate control period rather than discrete monthly or annual periods.

[6] Ordering Paragraph 9 states: "Under Assembly Bill 1890, the rate freeze has not ended for either PG&E or Edison." The term "rate freeze" is sometimes used to characterize the Legislature's setting rates at high levels above cost during the transition period, along with the other terms and conditions for rate determinations required by AB 1890.

enumerate the issues and set a schedule. Finally, we noted that we must also determine the extent and disposition of what formerly were termed "transition" or "stranded" costs left unrecovered, and that we would address this issue in proceedings subsequent to our determination regarding the end of the rate control period. (D.02-01-001, mimeo., page 25.)

2.2. Rehearing on End of Rate Controls and Positions of Parties

By Ruling dated May 7, 2002, the issues were enumerated and a schedule set for the filing and service of opening and reply briefs. Timely opening briefs were filed and served by PG&E, SCE, California Industrial Users (CIU), California Manufacturers & Technology Association (CMTA), California Large Energy Consumers Association (CLECA), Modesto Irrigation District (MID), and The Utility Reform Network (TURN). Timely reply briefs were filed by PG&E, SCE, CIU, CMTA and TURN.

Several parties contend that the rate freeze ended, became ineffective, or was mooted, sometime in the period from no later than March 31, 2000 to early 2001. Other parties argue that the rate freeze ended on March 31, 2002, pursuant to AB 1890.

PG&E, for example, argues that the rate freeze ended no later than March 31, 2000. PG&E bases this on estimates of final market valuations for utility-owned generation-related assets, and "zeroing out" of transition cost balances.

SCE contends that the rate freeze became ineffective in early 2001 upon the enactment of AB 6X (on January 18, 2001) and AB 1X (on February 1, 2001). TURN states that the rate freeze ended with AB 1X, not AB 6X. That is, the rate freeze ended, according to TURN, when AB 1X became effective on February 1, 2001.

CIU says that the rate freeze apparently did not end early, and thus ended on March 31, 2002, pursuant to AB 1890. According to CIU, the accounting true-up (adopted in D.01-03-082) prevented an artificial early termination of the rate freeze as desired by utilities, and resulted in the end date set by AB 1890.

CMTA asserts that both PG&E and SCE seemingly believe they fully recovered their transition costs in 2000, but that Commission adoption of the accounting true-up in March 2001 may have delayed the end of the rate freeze relative to the dates advocated by utilities. Nonetheless, CMTA contends that nothing can affect the statutory requirement that the rate freeze ended by March 31, 2002. Further, according to CMTA, "the end of the rate freeze is made moot…by the enactment of AB 6X…in the sense that it [the end of the rate freeze] cannot trigger the deregulation of utility generation." (Opening Brief, May 28, 2002, page 7.)

CLECA says the end of the rate freeze may have been made moot by the passage of AB 6X but if not, then the rate freeze ended on the statutory date of March 31, 2002, based on Commission adoption of the accounting true-up. MID asserts that regardless of whether utilities have fully recovered Commission-authorized transition costs, the rate freeze ended no later than March 31, 2002. The importance of the date depends upon what then happens with costs and rates after the rate freeze. That is, parties dispute whether and how the end of the rate freeze affects the permissible recovery of transition and other costs, and the resulting level of rates.

For example, PG&E asserts that it had recovered all of its transition costs by March 2000, and that post-freeze rates must now permit recovery of all remaining costs. In contrast, TURN and others argue that utilities assumed the risk of less than full transition cost recovery under AB 1890. Having failed to recover all transition costs by the end of the rate freeze, these parties contend that remaining costs may not be recovered, rates must be reduced to cost of service, and excess revenues (including surcharge revenues collected after the date the rate freeze ended) must be refunded to ratepayers. The amount of remaining costs, if any, and their disposition will be the subject of Phase 2 of this rehearing proceeding, as discussed more below.

2.3. Valuation of Generation Assets and Positions of Parties

Valuation of utility generation assets is related to the determination of the end of the rate freeze. On October 25, 2001, the Commission rejected PG&E's proposal to market value PG&E's hydroelectric generation assets prior to establishing PG&E's utility retained generation (URG) revenue requirement. (D.01-10-067.) We found that market valuation was not necessary for determining prospective ratemaking practices or rates for URG assets, but did not address market valuation for determining uneconomic cost recovery.

On December 21, 2001, the Assigned Commissioner directed parties to address whether or not AB 6X supersedes the requirement of § 367(b) that valuation of certain assets subject to valuation be completed by December 31, 2001.[7] (December 21, 2001 Assigned Commissioner's Ruling.) On January 15, 2002, timely comments were filed by PG&E, the California Hydropower Reform

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[7] In relevant part, this section says: "For those assets subject to valuation, the valuations used for the calculation of the uneconomic portion of the net book value shall be determined not later than December 31, 2001…" (§ 367(b).)

Coalition (CHRC), PacifiCorp, and the Office of Ratepayer Advocates (ORA). On January 25, 2002, timely reply comments were filed by PG&E, ORA and the California Resources Agency (Resources Agency).

PG&E asserts that AB 6X did not supersede or repeal the requirement to set the market value of utility generation assets by December 31, 2001. Consistent with PG&E's position, CHRC says that AB 6X did not implicitly repeal the market valuation requirement of § 367(b).

PacifiCorp contends that AB 6X supersedes the valuation required under AB 1890, and no valuation is necessary. ORA agrees that no valuation is necessary, but maintains we need not reach the issue of whether or not AB 6X supersedes AB 1890. ORA asserts that the return to cost-of-service ratemaking removes URG assets from those assets subject to valuation. The Resources Agency takes no position on whether or not AB 6X explicitly or implicitly repeals the market valuation requirement of § 367(b) or, if there is no repeal, whether utility retained generation assets remain subject to market valuation now that the Commission has restored cost-of-service regulation as a result of D.01-10-067.

3. Discussion

We agree with SCE, TURN, CMTA and CLECA that the rate control period became ineffective, was mooted and ended in early 2001. In particular, we find that the rate control period ended on January 18, 2001, the effective date of AB 6X. We also find that we are not required to undertake market valuation of remaining utility generation assets for the purpose of determining when the rate control period ended.

3.1. End of Transition and Return to Regulation with AB 6X

The purpose of AB 1890 was to transition California's electricity generation market from cost-of-service rate regulation to competition. The AB 1890 paradigm was essentially based on the assumption that California's generation market would be competitive by no later than April 1, 2002.

Recognizing the failure of the deregulation scheme established by AB 1890, the California Legislature called a halt to the transition by adopting AB 6X in January 2001. That is, AB 1890 had provided that the utilities' generation assets would be rate regulated by the Commission until those assets were subject to market valuation. AB 6X ended the transition and deleted the market valuation requirement relative to the transition. It also continues Commission regulation of utility generation facilities, unless and until the Commission authorizes disposal of those facilities, with disposal permitted no sooner than January 1, 2006. Moreover, it requires that the Commission ensure public utility generation assets remain dedicated to service for the benefit of California ratepayers, without any legislatively defined conditions or time limits.

Specifically, AB 1890 enacted, but 6X deleted, the following in its entirety:

> "Generation assets owned by any public utility prior to January 1, 1997, and subject to rate regulation by the commission, shall continue to be subject to regulation by the commission until those assets have undergone market valuation in accordance with procedures established by the commission." (Former § 216(h).)

Similarly, AB 1890 enacted, but AB 6X deleted, the following language:

> "…and utility generation should be transitioned from regulated status to unregulated status through means of commission-approved market valuation mechanisms." (Former § 330(l)(2).)

Further, prior to amendment by AB 6X, the law read:

> "The commission shall continue to regulate the nonnuclear generating assets owned by any public utility prior to January 1, 1997, that are subject to commission regulation until those assets have been subject to market valuation in accordance with procedures established by the commission." (Former § 377.)

As amended by AB 6X, the law now reads:

> "The commission shall continue to regulate the facilities for the generation of electricity owned by any public utility prior to January 1, 1997, that are subject to commission regulation until the owner of those facilities has applied to the commission to dispose of those facilities and has been authorized by the commission under Section 851 to undertake that disposal. Notwithstanding any other provision of law, no facility for the generation of electricity owned by a public utility may be disposed of prior to January 1, 2006. The commission shall ensure that public utility generation assets remain dedicated to service for the benefit of California ratepayers." (§ 377.)

Thus, effective January 18, 2001, the transition was terminated, the valuation requirement relative to the transition from regulated to unregulated status was terminated, Commission regulation continues, and public utility generation assets are to remain dedicated to service for the benefit of California ratepayers without condition or limit.

3.2. Rate Controls

The rate control period was to last until the earlier of March 31, 2002, or the date on which Commission-authorized uneconomic costs (also called transition or stranded costs) were fully recovered. Specifically:

> "These [June 10, 1996] rate levels for each customer class, rate schedule, contract or tariff option shall remain in effect until the earlier of March 31, 2002, or the date on which the commission-

> authorized costs for utility generation-related assets and obligations have been fully recovered." (§ 368(a).)

AB 1890 delegated to the Commission the responsibility of identifying and determining these recoverable costs. (§§ 367 and 368.) AB 6X did not delete or modify this responsibility.

Transition or stranded costs, full recovery of which would end the rate control period, were those that might become uneconomic as a result of the transition to a competitive market. In particular, transition or stranded costs were defined as:

> "…the uneconomic costs of an electrical corporation's generation-related assets and obligations identified in Section 367." (§368.)
>
> Pursuant to § 367:
>
> "The commission shall identify and determine those costs and categories of costs for generation-related assets and obligations…that may become <u>uneconomic as a result of a competitive generation market, in that these costs may not be recoverable in market prices in a competitive market</u>." (§ 367, emphasis added.)

AB 6X ended the transition of utility generation from regulated to unregulated status, and continues Commission regulation of those assets. In this new context, there are no longer any uneconomic costs (i.e., "costs for generation-related assets and obligations…that may become uneconomic as a result of a competitive market…" § 367). There are no remaining uneconomic costs because AB 6X ended the transition to a competitive market for utility generation assets. Hence, there are no transition or stranded costs that remain within the meaning of AB 1890.

Specifically in this context we have said:

> "Moreover, by conferring upon the Commission the authority to continue to regulate the utilities' retained generation under a cost-of-service approach, and deleting provisions requiring generation to be transitioned from regulated to unregulated status, these provisions [in AB 6X] removed any danger that the investment in such assets 'may become uneconomic as a result of a competitive generation market.' [Footnote 7.] (§ 367.) In other words, the investment in these assets no longer is a stranded or transition cost within the meaning of AB 1890."
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> "[Footnote 7] Under cost-of-service ratemaking, the concept of 'uneconomic' costs is not applicable. The concept only has relevance under a market-based rate regime." (D.02-11-026, mimeo., page 13.)

Thus, we find that the rate control period ended on January 18, 2001. It ended on January 18, 2001, because, effective that date, there are no longer any uneconomic, stranded or transition costs within the meaning of AB 1890 to recover. Recovery of these costs was otherwise put at risk by the transition to a competitive market. The purpose of the rate freeze was to give the utilities an opportunity to recover some or all of these costs. AB 6X stopped the transition, and ended the risk. Uneconomic, stranded or transition costs ceased to exist as a cost category on January 18, 2001.

3.3. Other Possible Dates

A limited number of other dates are candidate dates for the end of the rate control period. For the following reasons, however, these dates are not determinative.

3.3.1. March 31, 2000

PG&E asserts that the rate freeze ended no later than March 31, 2000. We are not persuaded by PG&E's arguments, as we discuss below.

According to PG&E, the Commission was required by AB 1890 to complete the final valuations of non-nuclear utility retained generation assets by December 31, 2001. Not having yet done so, PG&E says we must do so now. PG&E believes that any reasonable range of valuations will produce a determination that the rate freeze ended no later than March 31, 2000, based on the "zeroing out" of transition cost balances in various accounts (e.g., the Transition Cost Balancing Account or TCBA).

We disagree. Final valuation was not required by January 18, 2001. With the enactment of AB 6X on that date, we are no longer required to complete valuation.

After enactment of AB 6X, only one reference to market valuation remains in the sections dealing with the transition to competition and the rate freeze. The reference, in § 367(b), requires that calculation of the amount of transition costs eligible for recovery be based in part on market valuation of certain assets. But, costs eligible for recovery and that might otherwise have been "subject to valuation" (§ 367(b)) consisted only of costs associated with generation assets that "may become uneconomic as a result of [the transition to] a competitive market." (§ 367.) As discussed above, such potentially uneconomic costs within the meaning of AB 1890—including § 367—no longer exist.[8]

Said differently, valuation was only relevant in the context of recovery of "the uneconomic portion of the net book value" and "uneconomic costs." (§ 367(b) and § 367.) Uneconomic costs were in turn only relevant in the context

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[8] Contrary to PG&E's contention, this analysis does not depend upon repeal—implied or otherwise—of § 367(b). Section 367(b) remains intact. However, with the disappearance of transition costs, nothing exists to trigger its application.

of "a competitive generation market, in that these costs may not be recoverable in market prices in a competitive market…" (§ 367.) AB 6X continues Commission rate regulation, and deletes provisions requiring generation to be transitioned from regulated to unregulated status, as we discussed previously. Valuation in the context of uneconomic costs is no longer meaningful.

In addition, even if we were to undertake valuation now, completion of the valuation process would be unreasonably complex and controversial. PG&E, for example, has estimated different valuation amounts at different times. According to TURN, PG&E first estimated an interim market value of $2.8 billion in August 2000, but then proposed final market valuation of $4.1 billion only a few months later in the utility retained generation (URG) proceeding. This is an increase of $1.3 billion (46%) over a short period of time, and may or may not be dependent upon many variables (e.g., estimates of the cost of natural gas, oil, interest rates; the state of competition in the generation market). Parties may have other estimates of value. Hearings would be necessary to take evidence on disputed appraised values. This could be an exceedingly costly use of limited utility, party and Commission time and resources for results that, given Phase 2, are largely moot on a revenue requirement basis. Rather, limited resources should be devoted to Phase 2 of this proceeding.

Thus, we are neither persuaded by PG&E that the rate control period ended no later than March 31, 2000, nor that we are required to, or otherwise should, now undertake the final valuation process to determine the end of the rate control period.

3.3.2. January 17, 2001

The Legislature stated several guiding principles for the purpose of carrying out its intended electricity market restructuring. In particular, one such principle was:

> "The transition to a competitive generation market should be orderly, [and] protect electric system reliability…" (§ 330(t).)

On January 17, 2001, the Governor proclaimed a State of Emergency. The proclamation was based on a crisis in the electricity market (e.g., shortages of electricity, rolling blackouts affecting millions of Californians, threatened insolvency of California's major public utilities, imminent threat of disruptions constituting a condition of extreme peril to the safety of persons and property). The situation was not the Legislature's intended "orderly" transition protective of "system reliability."

We might conclude that the rate control period ended with the Governor's proclamation of a State of Emergency on January 17, 2001. We do not. Rather, on January 17, 2001, the Public Utilities Code still contained provisions calling for the transition, market valuation in the context of the transition, and eventual unregulated status of generation assets. (§§ 216(h), 330(l), and 377.) On January 18, 2001, those provisions were terminated by AB 6X. January 18, 2001 provides the clearer change in both context and law for Commission determination of the status of uneconomic costs that define the end of the rate control period.

3.3.3. February 1, 2001

TURN argues that AB 6X prevented any further divestiture of utility generation assets as a means of determining the market value of those assets, but did not change the allocation of risk and opportunity under the rate freeze, and was not the critical change in the statutory and regulatory landscape for purposes of determining whether or not the AB 1890 rate controls had ended. Rather, TURN asserts that AB 1X was the critical instrument in shifting the risk of procurement cost incurrence and rate recovery from utilities to customers.

According to TURN, AB 1X relieved the utilities of the burden of purchasing wholesale power on behalf of their customers (beyond the amounts provided by utility retained generation), and assigned that burden to the State in the form of DWR. TURN says that AB 1X also provided that rates be increased, if necessary, to recover DWR's costs, and directed that generation revenues not required by utilities be redirected to DWR.

TURN contends that the rate freeze was intended to create both an opportunity for transition cost recovery and the risk of non-recovery. TURN asserts that AB 1X granted utilities virtual certainty of cost recovery. Under TURN's theory, as of February 1, 2001, all generation cost components were recoverable on a cost-of-service basis, with utility retained generation costs recovered in utility rates and wholesale market costs recovered by DWR. As a result, TURN says that with AB 1X on February 1, 2001, all further headroom and stranded cost accruals ceased to exist, and the rate freeze came to an end.

We disagree. Commission determination of uneconomic costs irreversibly changed upon the cessation of the transition to competition pursuant to AB 6X on January 18, 2001. With that cessation, uneconomic costs within the meaning of AB 1890 no longer exist. (D.02-11-026, mimeo., page 13.)

Moreover, the continuation of Commission regulation beginning January 18, 2001, fundamentally altered the system for cost recovery, along with the risk of non-recovery. That shift did not depend upon AB 1X (although AB 1X provided further guidance and authority for implementation). Rather, AB 6X, was the critical change in the statutory and regulatory landscape for purposes of determining whether or not the AB 1890 rate controls had ended. Phase 2 will determine what costs, if any, remain, and how much may be recovered.

In addition, DWR acquisition of electricity did not wait until February 1, 2001. Rather, it began on January 18, 2001, or shortly thereafter, pursuant to the State of Emergency proclaimed by the Governor on January 17, 2001, and the authority granted therein for DWR to begin procurement of electricity.

TURN argues that AB 6X may have been necessary in rendering the AB 1890 cost recovery scheme unworkable and moot, but was not sufficient to bring about that result. Rather, TURN contends that absent AB 1X, the utilities would have continued to accrue a negative Competition Transition Charge (CTC) as a result of wholesale power costs in excess of the frozen rate level. TURN says it was AB 1X that relieved utilities of the burden of purchasing wholesale power, and provided for rate increases to recover DWR's costs.

TURN's argument is not compelling. AB 6X was both necessary and sufficient to render meaningless the concept of uneconomic costs, and to continue Commission regulation of utility generation assets. With this changed regulatory structure, utilities would not necessarily have had to continue to collect a negative CTC. Rather, given that AB 6X ended the rate control period on January 18, 2001, rate levels could have been adjusted to prevent a negative CTC. Rate levels were in fact adjusted by surcharges totaling $0.04/kWh. TURN is correct that AB 1X modified the rate recovery scheme, but is incorrect that it took AB 1X to end the rate freeze.

TURN also contends that it is inaccurate to interpret AB 6X as returning Commission rate regulation to generation assets that, in the absence of AB 6X, would have otherwise become unregulated upon market valuation. In support, TURN cites a Commission statement interpreting § 377 before enactment of AB 6X. TURN says:

> "In D.00-01-024, the Commission interpreted Section 377 as it existed <u>before</u> AB 6X was enacted as providing for 'continuing regulation even <u>after market valuation</u>.' D.00-01-024, fn.1 [emphasis added]. The notion that market valuation would yield deregulated assets appeared to the Commission then to be 'overly broad.' <u>Ibid.</u>" (TURN Opening Brief dated May 28, 2002 at page 4, quoting from D.00-01-024, footnote 1.)

To the contrary, we had not conclusively determined that regulation generally continued after market valuation. Rather, the Commission statement cited by TURN is a footnote in an order denying rehearing of a decision. (D.00-01-024 denying rehearing of D.99-07-031.) The footnote states: "PG&E maintains that under AB 1890, the generation lands are freed from Commission regulation after market valuation." We responded: "We do not find it necessary to address the merits of this interpretation…D.99-07-031 does not deal with the issues of what happens after market valuation." (D.00-01-024, footnote 1, 2000 Cal. PUC LEXIS 4.) Thus, rather than finding continued regulation, we found we did not need to address the issue.

TURN is correct that the footnote goes on to say:

> "Furthermore, we note that PG&E's interpretation of AB 1890 appears to be overly broad. (See Pub. Util. Code § 377, for one example of continuing Commission regulation even after market valuation.)" (Id.)

At that time, however, § 377 contained the following language (which has since been repealed):

> "If, after market valuation, the public utility wishes to retain ownership of nonnuclear generation assets in the same

> corporation as the distribution utility, the public utility shall demonstrate to the satisfaction of the commission, through a public hearing, that it would be consistent with the public interest and would not confer undue competitive advantage on the public utility to retain that ownership in the same corporation as the distribution utility."

This was one example of possible continuing Commission regulation even after market valuation. The statement in the footnote in D.00-01-024, however, does not show that we generally did or did not interpret AB 1890 as conferring continued Commission rate regulation over all utility generation assets after valuation. Rather, the matter was not conclusively decided.

Thus, we are not persuaded by TURN that the rate freeze ended with AB 1X on February 1, 2001.

3.3.4. March 31, 2002

Several parties suggest that the rate control period must have ended on March 31, 2002, the last date allowed by statute. We decline to adopt this date.

To determine that the rate control period did not end before March 31, 2002—and therefore that it ended on March 31, 2002—requires that (a) there were authorized transition costs that remained on March 31, 2002, and (b) we now complete the asset valuation process. For all the reasons stated above, there were no transition costs within the meaning of AB 1890 following enactment of AB 6X, and completion of the valuation process does not make sense, and is not required, after January 18, 2001.

4. Phase 2

We initiate Phase 2 of this rehearing for the purpose of determining "the extent and disposition of stranded costs left unrecovered." (D.02-10-001, mimeo., page 25.[9] [10]) We leave the details of Phase 2 to the assigned Administrative Law Judge (ALJ), in consultation with the Assigned Commissioner. We anticipate, however, that the ALJ should permit parties to file and serve prehearing conference (PHC) statements, conduct a PHC, and issue the equivalent of a Scoping Memo to outline the issues and schedule for Phase 2. Each party's PHC statement should identify what that party believes are the issues, propose a schedule, and address anything else necessary for the scope, schedule and conduct of Phase 2.

We generally envision that the process may include several steps in the following order. Parties should comment on this approach in PHC statements. The process would be:

a. PG&E and SCE would each serve a document that shows total electric utility costs and revenues each month over the rate freeze period (January 1, 1998 through January 18, 2001) on a basis consistent with the accounting true-up adopted in

[9] Although we used the phrase "stranded costs" in that decision, we subsequently determined that, upon enactment of AB 6X, there no longer are any "uneconomic," "stranded," or "transition" costs within the meaning of AB 1890. (D.02-11-026.) Phase 2 concerns the potential, if any, for recovery of costs that formerly (prior to passage of AB 6X) were termed "uneconomic," "stranded," or "transition" costs within the meaning of AB 1890.

[10] Evidently contending that Phase 2 would be illegal, TURN asserts "***nothing*** in AB 6X can be read to repeal the prohibition on stranded cost recovery after 3/31/02." (TURN Opening Brief dated May 28, 2002, page 16, emphasis in original.) We subsequently disposed of this issue, however, saying:

> "…ABX1-6 clearly and expressly confer[s] on the Commission jurisdiction over regulation of the utilities' retained generation assets, including rates. Such jurisdiction includes, for example, authority to determine whether and to what extent the utilities may recover in rates their investments in these retained generation assets." (D.02-11-026, mimeo., page 13.)

D.01-03-082 (Ordering Paragraphs 7 and 8). The document should show the monthly balances in the Transition Revenue Account (TRA), TCBA, and the Generation Memorandum Account (GMA). It should not reflect any estimated market valuation of remaining generation assets. It should present any other data that is necessary and relevant to address costs and revenues under the rate freeze.

b. Of the net TCBA undercollection calculated pursuant to the accounting true-up (D.01-03-082), PG&E and SCE would each identify all generation-related costs that have subsequently been included in rates and / or rate base for recovery after January 18, 2001, pursuant to the URG decision (D.02-04-016) or any other decision.

c. PG&E and SCE would each identify all generation-related costs that have been booked in their TCBA that the Commission has not yet authorized to be included in rates. For such costs, PG&E and SCE should each identify costs for which they now seek recovery, and the rates or methods to accomplish that recovery.

d. PG&E and SCE should provide any other information they believe necessary to fully address the extent and disposition of what were previously called uneconomic, stranded or transition costs.

Once utilities serve these showings, parties should have an opportunity to comment. Utilities should be permitted to respond.

Parties may or may not elect to argue whether costs previously identified as uneconomic, transition or stranded (which are now no longer uneconomic, transition or stranded) may reasonably be recovered from ratepayers.[11] These

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[11] The legality of permitting such cost recovery has already been addressed by the Commission. (D.02-11-026; *see* footnote 10 above.) The purpose of Phase 2 is not to reexamine this issue, but rather to determine as a matter of sound policy whether, and to what extent, recovery of such costs should be permitted. Accordingly, we do not

Footnote continued on next page

might be costs that have already been recovered in rates, costs included in present rates for future recovery, or costs not yet included in rates. Parties may also address the amount of cost recovery, if any, that is necessary to return PG&E and SCE to reasonable financial health. (D.02-11-026.)

An evidentiary hearing should be held if any party identifies a material issue of disputed fact or expert opinion. If a hearing is scheduled, parties should have the opportunity to serve proposed direct and rebuttal testimony in advance of the hearing on the specifically identified disputed fact or opinion.

We will conduct Phase 2 on the premise that the principles of AB 6X relied on here continue to apply. That is, rates after January 18, 2001, for utility retained generation are to be based on continued Commission regulation. Commission regulation of those assets is on the basis of cost-of-service. (D.02-04-016.) No facility for the generation of electricity owned by a public utility may be disposed of prior to January 1, 2006, and disposal may occur only after authorization by the Commission under § 851. Public utility generation assets are to remain dedicated to service for the benefit of California ratepayers. (§ 377 as modified by AB 6X.)

Parties should also comment in PHC Statements on whether or not there is anything material to address in Phase 2 that has not already been, or will not be, addressed in other Commission proceedings. That is, the costs at issue for Phase 2 may already have been fully addressed and resolved for SCE upon full recovery of the balance in SCE's procurement related obligations account (PROACT), plus other AB 1890 related accounts. (A.03-01-019, D. 03-07-029;

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address here arguments concerning the legality of permitting such recovery. Such arguments should be, or have been, raised in connection with D.02-11-026.

A.00-03-047.) Similarly, the costs at issue for Phase 2 might be fully addressed and resolved for PG&E upon PG&E's emerge from bankruptcy, and recovery of costs in other AB 1890 related accounts. (I.02-04-026; A.00-03-038.) Each party's PHC Statement should identify any material issue which the party recommends be resolved in Phase 2 that has not been, or will not be, resolved in other Commission proceedings.

Finally, parties should comment on whether or not changes to customer bills should be made, and, if so, whether the changes should be considered in Phase 2, each utility's general rate case, or elsewhere. That is, customer bills may now refer to rate control period matters (e.g., 10 percent legislatively mandated rate discount for some customers) that may no longer apply. PHC statements should comment on whether or not such items should be addressed in Phase 2.

5. Consolidation of Phase 2 with A.00-07-013

In July 2000, PG&E filed an application seeking review and recovery of costs recorded in its Electric Restructuring Costs Account (ERCA) for 1999, and forecast for 2000 and 2001. (Application (A.) 00-07-013.) Protests were filed by TURN, ORA, and Enron Corporation (Enron). Parties agreed hearings would be necessary. Processing of the proceeding, however, was delayed as a result of the energy crisis.

Parties were recently asked to consider and propose procedural options on how to most efficiently address the issues raised in the application. (Ruling dated October 17, 2002.) Only PG&E responded.

PG&E points out that the task of updating its ERCA application will be significant. Further, PG&E says that the issues raised in the ERCA proceeding are integrally related to the Commission's determination of the end of the rate control period. PG&E recommends that the Commission convene a workshop to consider ways to consolidate or coordinate the issues in PG&E's ERCA application with other proceedings regarding the end of the rate freeze.

We agree with PG&E that the issues in the ERCA proceeding and this matter are closely related. We decline to convene a workshop to further address options on how to consolidate or coordinate matters. Rather, we believe it will be an efficient use of limited Commission and party resources to consolidate A.00-07-013 with the cost recovery questions to be answered in Phase 2 of the rehearing. Parties should include proposals in Phase 2 PHC statements on how best to join cost recovery issues raised in A.00-07-013 with other Phase 2 issues.

6. Comments on Draft Decision

On July 22, 2003, the draft decision of Commissioner Lynch was filed and served on parties in accordance with Public Utilities Code Section 311(g)(1) and Rule 77.7 of the Commission's Rules of Practice and Procedure. Comments were filed and served on August 11, 2003 by _________. Reply comments were filed and served on August 18, 2003 by ___________.

7. Assignment of Proceeding

Loretta M. Lynch is the Assigned Commissioner, and Burton W. Mattson is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. Effective January 18, 2001 (the effective date of AB 6X), the transition of utility retained generation assets from regulated to unregulated status through means of Commission-approved mechanisms ended, the valuation requirement for those assets relative to the transition ended, Commission regulation of those assets continues, and those assets are to remain dedicated to service for the benefit of ratepayers.

2. The Commission has the responsibility to identify and determine recoverable costs for the purpose of determining when specified rate levels may be changed (i.e., when the rate control period or "rate freeze" ended).

3. Commission-authorized costs, full recovery of which would end the rate control period, were those that would become uneconomic as a result of the transition to a competitive market (unregulated status), and would not be recoverable in market prices in a competitive market.

4. The Commission had not completed market valuation of utility generation assets when AB 6X became effective on January 18, 2001.

5. On January 18, 2001, uneconomic costs ceased to exist as a category of separately identified recoverable costs, given the end of the transition of utility generation assets from regulated to unregulated status, the continuation of Commission regulation of these assets, and the removal of any danger that the investment in such assets may become uneconomic as a result of a competitive generation market.

6. The concept of uneconomic costs only has relevance under a market-based rate regime.

7. AB 6X stopped the transition, and ended the risk of failing to recover costs that were previously identified as uneconomic.

8. Completion of final market valuation of utility generation assets was not required by January 18, 2001.

9. Final market valuation ceased to be meaningful on January 18, 2001, because uneconomic costs as a separate cost category within the meaning of AB 1890 ceased to exist on that date.

10. Final valuation of utility generation assets performed today would be complex and controversial.

11. On January 17, 2001, the Governor proclaimed a State of Emergency in the electricity market, but the Commission was still obligated at that time to determine the end of the rate control period in terms of recovery of uneconomic costs pursuant to a transition of generation facilities from regulated to unregulated status.

12. Commission determination of uneconomic costs irreversibly changed on January 18, 2001, with the cessation of the transition to unregulated status and competition.

13. DWR acquisition of electricity was authorized to begin before February 1, 2001.

14. Rate levels could have been adjusted to prevent a negative CTC balance, among other reasons, and were adjusted by surcharges totaling $0.04/kWh in January and March 2001.

15. A determination that the rate control period did not end until March 31, 2002, would require that uneconomic costs within the meaning of AB 1890 persisted until March 31, 2002, and would also require completing final market valuation of utility generation assets.

16. The issues raised in the PG&E's ERCA proceeding (A.00-07-013) are closely related to the Commission's determination of the end of the rate control period, and it is an efficient use of limited Commission and party resources to consolidate A.00-07-013 with the cost recovery questions to be answered in Phase 2 of the rehearing.

Conclusions of Law

1. The Public Utilities Code at one time provided—but not longer provides—that utility generation assets owned by a utility prior to January 1, 1997, and subject to rate regulation by the Commission, continue to be regulated by the

Commission until those assets had undergone market valuation in accordance with procedures established by the Commission. (Former §§ 216(h) and 377, added by AB 1890 and deleted by AB 6X.)

2. The Public Utilities Code currently provides that the Commission shall regulate electricity generation facilities owned by a public utility prior to January 1, 1997 unless and until the Commission authorizes disposal of those facilities under § 851, with no disposal permitted prior to January 1, 2006, and with the Commission ensuring that public utility generation assets remain dedicated to service for the benefit of California ratepayers. (§ 377 pursuant to AB 6X.)

3. The Public Utilities Code provides that electric rates remain at specified levels until the earlier of March 31, 2002, or the date on which certain Commission-authorized costs for utility generation-related assets and obligations are fully recovered. (PU Code § 368(a).)

4. Commission-authorized costs, the recovery of which would end rate controls before March 31, 2002, are costs that may become uneconomic as a result of a competitive generation market, in that these costs may not be recoverable in market prices in a competitive market. (§§ 367 and 368.)

5. Uneconomic costs ceased to have meaning as a category for cost recovery on January 18, 2001, the effective date of AB 6X.

6. The end of the rate control period should be determined to be January 18, 2001.

7. Final market valuation is no longer required in order to determine the date that marks the end of the rate control period.

8. Phase 2 of this rehearing should be undertaken to determine the extent and disposition of costs previously defined as uneconomic, transition or stranded

costs; should generally follow the steps stated in this order, subject to further orders of the assigned ALJ in consultation with the Assigned Commissioner; and should be conducted on the premise that the principles of AB 6X relied on in this order continue to apply (i.e., continued Commission regulation of utility retained generation assets; no disposal of those assets until at least January 1, 2006; disposal only when authorized by the Commission; continued dedication of public utility generation assets to service for the benefit of California ratepayers).

9. The Commission is authorized and obligated to set rates that are just, reasonable and sufficient.

10. Phase 2 should determine the amount of cost recovery, if any, of costs which were previously defined as uneconomic, but recovery of which now may be necessary for the purpose of setting just, reasonable and sufficient rates to maintain the reasonable financial health of PG&E and SCE.

11. PG&E's ERCA proceeding should be consolidated with Phase 2 of this rehearing.

12. This order should be effective today in order to permit prompt commencement of Phase 2, and a timely determination of the extent and disposition of costs previously defined as uneconomic, stranded or transition, as well as recovery of PG&E's ERCA costs.

INTERIM ORDER

IT IS ORDERED that:

1. The date on which Commission-authorized costs defined in Public Utilities Code §§ 367 and 368 were recovered, for the purpose of determining when rates were no longer to remain at 1996 levels fixed pursuant to § 368, was January 18, 2001. Market valuation of the retained generation assets of Pacific Gas and

Electric Company and Southern California Edison Company need not and shall not be undertaken for the purpose of determining this date.

2. The rehearing of Decision (D.) 01-03-082 ordered by D.02-01-001 remains open for the purpose of conducting Phase 2. Phase 2 shall determine the extent and disposition of costs previously defined as uneconomic, transition or stranded. The recovery of these costs, if any, shall be consistent with the principles in the Public Utilities Code upon which this order is based: continuing Commission regulation of utility retained assets; no disposal of utility retained generation assets until at least January 1, 2006; disposal of those assets permitted only after authorization by the Commission pursuant to Public Utilities Code § 851; and dedication of public utility generation assets to service for the benefit of California ratepayers.

3. Application 00-07-013 is consolidated with Phase 2 of this rehearing.

This order is effective today.

Dated ___________________________, at San Francisco, California.